

STATE OF MICHIGAN
IN THE SUPREME COURT

PINE OAKS, LLC

Plaintiff/Appellant,

v.

Supreme Court Case No. 127856
Court of Appeals Case No. 249163
Circuit Court Case No. 03-45297-AV
District Court Case No. HU-02-2650-LT

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Defendants/Appellees.

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127856
Suppl (267)
DEFENDANTS/APPELLEES' SUPPLEMENTAL BRIEF

FILED
NOV 16 2005
CORBIN R. DAVIS
CLERK
MICHIGAN SUPREME COURT

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ARGUMENT

Pursuant to this Court's order of October 19, 2005 the Defendants submit this supplemental brief in response to cases and arguments raised in Plaintiff's application for leave to appeal. The Court of Appeals' decision to reverse the judgment of the Circuit Court and remand the case for further proceedings should be upheld. Contrary to Plaintiff's contention, the defenses available in summary proceedings after foreclosure need not be restricted to protect buyers or facilitate foreclosure. Moreover, equitable relief has historically been available after foreclosure, and the District Court and Circuit Court therefore erred in holding that equitable considerations could not be taken into account. In addition, the procedural irregularities in the foreclosure, and the equitable issues raised by Defendants, must be addressed at the trial court level.

I. Narrowly restricting defenses available in summary proceedings following foreclosure is not required to protect buyers or facilitate foreclosure.

The District Court in this case refused to consider the equities between the parties or any mortgage or notice issue outside the statutorily required foreclosure notices. Plaintiff supports this position by citing alleged adverse effects that allowing consideration of these issues would have on the mortgage foreclosure process. However, a closer look at the process shows that the Plaintiff's fears are unjustified.

A. Most foreclosed properties are bought by the foreclosing lenders for the outstanding loan amount, with full knowledge of the loan history.

Plaintiff's argument looks at the process entirely from the perspective of third party bidders at foreclosure sales. Plaintiff alleges that these buyers cannot know

whether the mortgage was properly accelerated, or whether other requirements of the mortgagee in the agreement were followed. Therefore, according to Plaintiff, no such issues should be allowed to be raised to undermine the buyer's rights after the foreclosure sale.

However, third party bidders are relatively rare in the real world of residential foreclosure. The residential foreclosure sale is not in general a process involving multiple bidders reaching something approximating fair market value. Lenders are the only bidders in most foreclosure sales, bidding the outstanding balance of the mortgage plus costs.

Two empirical studies in recent years examined the nature of foreclosure sales. Stark, *Facing the Facts: An Empirical Study of the Fairness and Efficiency of Foreclosures and a Proposal for Reform*, 30 U Mich JL Ref 639 (1997); Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure – An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 Cornell L Rev 850 (1985). Both studies show that the vast majority of foreclosures – 77% to 90% - whether judicial or by advertisement, result in purchase by the foreclosing lender, as the only bidder, bidding the mortgage balance plus costs. Thus, the buyer at most foreclosure sales is not an outsider to the mortgage and its history, but a party to it, with full knowledge of the content of the mortgage, the history between the parties, the full foreclosure process and the equities involved.

B. Third-parties who buy at foreclosure sales are generally on notice of potential issues by the big gap between sale price and the value of the property.

Those sales where the foreclosing lender buys rarely result in a windfall when the lender resells the property. However, the same is not true for the small number of cases where third-party bidders purchase the property. Third-party bidders tended to make “very large profits”, which Prof. Stark (at the time chair of the ABA Foreclosure and Related Remedies Committee) called “unconscionable,” profits which ranged in her study from 32% to 326%. Stark, *supra*, at 667.

Reviewing these studies, Professors Grant Nelson and Dale Whitman questioned why properties with such large equity would go to bidders in foreclosure without being sold at market rates by the borrowers. They saw the most plausible explanations as mental and physical illnesses of the borrowers, marital or family problems or temporary or seasonal housing market slumps. Nelson and Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 Duke LJ 1399, 1429 (2004). They saw the loss to vulnerable borrowers in these anomalous situations as a principal reason for foreclosure reform.

Thus, the third-party bidders that Plaintiff is concerned about are usually involved when the size of the equity being lost by the borrower gives everyone involved notice that there may be serious equitable issues in the foreclosure. The Court of Appeals noted that this was the case with the Devries sale, and the studies show that this is the case in general.

C. Purchasers at foreclosure sale subject to rescission will never lose their investment.

While borrowers with substantial equity stand to lose a lot in this process, the buyer at foreclosure sale does not, even if courts are later able to consider and order equitable rescission. If the sale is rescinded due to procedural irregularities and

equitable considerations, the buyer will have to be put back into the position the buyer was in before the sale. The buyer will be entitled to the return of the price paid at the foreclosure sale, either from the borrower or the lender, in order to effectuate the rescission. Thus, the consequences for the foreclosure purchaser of the borrower getting a hearing on defects and iniquities in the foreclosure process are not dire. See *Grabendike v Adix*, 335 Mich 128, 140, 55 NW2d 761 (1952), holding that in order for a party to obtain cancellation or rescission of a contract, the other party must be restored to the status quo.

II. Equitable relief has historically been available after foreclosure, in the proper court.

Defendants argued in their Brief in Response to Application for Leave that Plaintiff had misinterpreted *Reid v Rylander*, 270 Mich 263, 258 NW 630 (1935). *Reid* did not allow equitable issues and issues stemming from the mortgage contract to be used as defenses in front of the circuit court commissioner in a summary proceeding, but noted such issues could be raised in a bill to set aside the foreclosure filed in equity. *Reid*, supra, at 269-270.

The same distinction is clear in the other main case relied on by Plaintiff, *Gage v Sanborn*, 106 Mich 269, 64 NW 32 (1895). One of the issues raised in defense of the summary proceeding following foreclosure in that case was whether the Plaintiff, assignee of the mortgagee's interest after purchase at the foreclosure sale, was really an agent of another party in the matter, who was contractually required to pay the mortgage but did not.

The Court in *Gage* noted that summary proceedings are actions at law with very limited jurisdiction. The commissioner could only look at narrow questions regarding

the foreclosure sale. If evidence showed a cognizable claim that the defendant had legal title, the summary proceeding had to be dismissed. *Gage, supra*, at 278.

However, the issues the *Gage* defendant was raising did not involve legal title. The issue was whether the payment for the assignment should be considered to be a redemption of the property in foreclosure, given the duty of the third party to pay the mortgage and the alleged agency relationship with the assignee. These issues had to be handled by a court of equity, and it was up to the defendant to file such a suit.

A court of equity only could declare this purchase from the bank a redemption.... All of these questions are important as bearing upon the right of the defendant to redeem, but they have no bearing upon the legal title, which vested by the foreclosure deed, *subject, of course, to the power of court of equity to set the same aside or permit redemption in a proper case.*

Gage, supra, at 278 (emphasis added).

The Defendants in the instant case did properly invoke the power of a court of equity, in the District Court, which now has equitable jurisdiction in summary proceedings, and in the Circuit Court. *Gage* and *Reid*, the mainstays of Plaintiff's argument, actually support the right of the Defendants to a hearing on the serious equitable issues raised by the facts of this case.

III. The significance and effect of the procedural irregularities and equitable issues raised by Defendants needs to be addressed at the trial court level.

The Plaintiff argued that various irregularities and equitable issues discussed by the Court of Appeals were not significant enough to warrant setting aside of the foreclosure. However, the facts about the irregularities were never heard in full by the trial court, and no findings on them were made. Rather, the trial court ruled that no issues, legal or equitable, that involved facts outside the statutory notices, including what

name should have gone on the notices, could be raised in the summary proceeding. The trial court did not find that claimed irregularities did not have a significant effect on the foreclosure, or that claimed equities were not enough to override the rights of the foreclosure buyer. Instead, the trial court erroneously held that these issues could not be raised at all.

An example is the extra notice requirement in the mortgage itself, which was not complied with. This notice gives the homeowner a thirty day period before acceleration to bring the mortgage up to date, and warns the homeowner of the consequences for failure to do so. On Plaintiff's motion, the trial court excluded any evidence of this breach or its effects on the homeowners' ability to keep the house out of foreclosure. Having successfully kept the entire issue out of the proceedings, Plaintiff now asks this Court to find that the failure to give the notice did not have a significant impact on the Defendants' ability to protect themselves from loss of their house. The nature of the breach and the effect on the parties should be addressed by the trial court.

Similarly, the Plaintiff pick a phrase out of the Court of Appeals decision to disparage both the opinion and the seriousness of the effort made by the Defendants to timely redeem after foreclosure sale.

If the Court of Appeals decision is allowed to stand, Michigan law will be that if the property owner "believes" he redeemed from the foreclosure sale, the redemption period is extended for unknown time.

Plaintiff's Application for Leave to Appeal, p. 20.

Of course, this is not what the Court of Appeals ruled. Good faith belief may be considered in determining the equities between the parties, but the redemption efforts here were not limited to good faith belief. An entire transaction took place, with a

closing, a lender, a title company, redemption money given to the title company, a check sent for redemption, a letter from the foreclosing lender acknowledging receipt, and the recording of a certificate of discharge of the mortgage by the foreclosing lender. Cf. *Acker v Weadel*, 236 Mich 374, 381, 210 NW 212 (1926), holding that real estate improvements that were “made in good faith by an innocent party in possession under a mistaken claim of ownership” can result in that party having an equitable lien on the real estate. It is the responsible actions of the homeowners and their good faith belief that are compelling.

But the Court of Appeals did not decide that these factors and irregularities in the process require rescission of the foreclosure or any other particular action. Rather, the Court of Appeals ruled that these claims should be heard. If the Court of Appeals decision is reversed and the District Court orders reinstated, no court will have heard the issues raised by Defendants, no court will have made findings of fact about them, no court will have weighed their significance for the parties or the foreclosure process. The Court of Appeals decision did not prejudice the outcome; it only required that the homeowners in this case get their day in court.

CONCLUSION

For the reasons noted above, Plaintiff/Appellant's application for leave to appeal should be denied.

Respectfully Submitted:



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November 15, 2005